Supreme Court of the United States

October Term, 1942

No. 7

IN THE MATTER

of

THE WESTERN PACIFIC RAILROAD COMPANY, a corporation,

Debtor,

FREDERICK H. ECKER, JOHN W. STEDMAN and REEVE SCHLEY, constituting the INSTITUTIONAL BONDHOLDERS COMMITTEE,

Petitioners,

vs.

WESTERN PACIFIC RAILROAD CORPORATION, a corporation; A. C. JAMES CO., a corporation; THE RAILROAD CREDIT CORPORATION, a corporation; THE WESTERN PACIFIC RAILROAD COMPANY, a corporation; IRVING TRUST COMPANY, a corporation, as substituted Trustee under the General and Refunding Mortgage of Western Pacific Railroad Company; RECONSTRUCTION FINANCE CORPORATION; and CROCKER FIRST NATIONAL BANK OF SAN FRANCISCO and SAMUEL ARMSTRONG, as Trustees under the First Mortgage of The Western Pacific Railroad Company, a corporation,

Respondents.

REPLY BRIEF FOR INSTITUTIONAL BONDHOLDERS COMMITTEE, PETITIONERS

On Writ of Certiorari to the United States Circuit Court of Appeals for the Ninth Circuit

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October 12, 1942.

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[1]References to Section 77 of the Bankruptcy Act are too frequent to enumerate. Pertinent portions of Section 77 are printed in Appendix A of the Committee's main brief.

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Many of the arguments of the James Interests[1] and of RCC[2] were anticipated in the Committee's main brief. The answering briefs of those respondents, however, have raised certain new questions or given new implications to old arguments. The Committee therefore feels it necessary to file this reply brief.

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[1]The James Interests, as shown in the Committee's main brief, p. 50, include A. C. James Co. (ACJ), Western Pacific Railroad Corporation (WP Corp.), and the Debtor.

[2]The Railroad Credit Corporation.

I

The argument that the Commission lacked power to approve the Commission Plan, on the ground that it differs in material respects from any proposal of any of the parties

For the first time in the seven years of this proceeding the James Interests attack the power of the Commission to promulgate and approve the Commission Plan.[1]

They assert "there is no language in Section 77 which * * * gives to the Commission the power and the responsibility of framing plans of reorganization for railroads," and argue that the express power granted to the Commission to "approve a plan, which may be different from any which has been proposed" was intended by Congress to limit the Commission to making "minor changes in the plan, consistent with the general intent and agreement of the parties."[2] Their protest that the Commission has no power "to originate plans by administrative fiat"[3] is sought to be bolstered by the implication that the Commission has not "allowed" the parties "to renegotiate and adjust their contractual relationships * * * relieved from the unreasonable limitations of the unsound economic theories" of the Commission. These arguments are baseless both in fact and in law.

It was no fault of the Commission that "The parties to this proceeding did not agree upon a plan of reorganization."[4] All except the James Interests did agree upon the

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[1] W. Corp. main brief, p. 20; ACJ main brief, pp. 75-81.
[2] ACJ main brief, pp. 77 and 80, respectively.
[3] ACJ main brief, p. 81.
[4] ACJ main brief, p. 99.

RCC Plan.[1] ACJ adhered to its view, still asserted here, that the "public interest" permitted retention of all outstanding debt as new debt and that the "absolute priorities" of the First Mortgage Bondholders could adequately be recognized by turning each $1,000 5% First Mortgage Bond, with its large accumulation of interest, into a $1,000 4% *wholly non-cumulative* Income Bond.[2]

The Committee urged the Commission to mediate. However unwise the Committee may believe the Commission to have been in declining that role, the Committee recognizes the clear discretion of the Commission so to refuse.

The Commission had no alternative but to decide all the disputed issues upon their strict merits. Recognizing this situation, the Committee and RFC (while still expressing willingness to compromise on the RCC Plan) joined in submitting to the Commission a proposed plan, based on their views of the merits, which was the fundamental basis of the Commission Plan.[3] The only substantial change made

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[1]R. 693. That Plan increased the Preferred Stock under the Commission Plan by $18,413,928 and the number of shares of no par value Common Stock by 30,000 primarily in order to allot some of the Common Stock to WP Corp. The RCC Plan was largely the result of a negotiation for compromise in which the then Chairman of the Reconstruction Finance Corporation (RFC), Mr. Jesse Jones, was most helpful.

[2]R. 105. While the ACJ proposal also gave the First Mortgage Bondholders a "bonus" of five shares of new Common Stock, that Common Stock was so far away from earnings as to be wholly worthless. The ACJ proposal also gave the existing junior debt new 4% Income Debentures of equal principal amount (each $1,000 Debenture convertible into $1,500 6% Preferred Stock) and a similar "bonus" of five shares of new Common Stock. The present First Mortgage Bonds mature 1946. The ACJ proposal was that the new Income Bonds mature 1987 and the new Income Debentures 1957 (R. 106, 111).

[3]R. 775, 756, 695-701.

by the Commission was to increase the allotment of new securities to the RCC and ACJ Notes beyond those which the Committee thought justified.

But even were the James Interests correct in their factual assertion, they are wrong as a matter of law in contending that Section 77 gave the Commission no power to make anything but "minor changes" in proposals of the parties. Congress had no intention of creating reorganization machinery under which, to use the language of WP Corp., "It may be that no plan can be devised which will meet both these tests," *i.e.*, be both "compatible with the public interest" and "fair and equitable." "The result is simply that no reorganization can be accomplished."[1]

The James Interests rely upon the fact that in the expression "the Commission * * * shall approve a plan, *which may be different from any which has been proposed*,"[2] the italicized words may, as a matter of composition, be parenthetical. Their argument gives to the form of composition a wholly unnatural and unnecessary effect in construing it as defeating the legislative intent indicated by Congress.

The report of the House Committee on Judiciary, of which Representative Sumners of Texas was Chairman, stated:

> "The section [77 (d)] specifically provides that the plan recommended by the commission may be one of several plans presented, a modification of any, *or an entirely new plan of the commission.*" (72nd Cong.,

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[1]WP Corp. main brief, p. 20.

[2]All italics in quoted matter throughout this brief have been supplied, unless the contrary is indicated.

2nd Sess., Report No. 1897 to accompany H. R. 14359).[1]

II

The argument that in determining whether a plan is "compatible with the public interest" the Commission may limit only the new fixed charge obligations and is powerless to require that any part of the existing debt shall be converted into stock

The James Interests argue that because Section 77(b)(4) expressly provides that a plan shall provide for fixed charges for which "there shall be adequate coverage * * * by the probable earnings available for the payment thereof," the Commission is without power, in the "public interest," to relate contingent charges to "probable earnings reasonably foreseeable for the future"[2] or to concern itself that the new shares of common stock (allotted to senior creditors for part of their claims) shall not "become mere tokens for stock market speculation."[3] The Commission's belief that the "public interest" (let alone the private

[1]Representative La Guardia, also a member of the House Committee on Judiciary, who took an active part in guiding Section 77 through the House, stated:

"Lest there be the slightest doubt as to the wide power and control the new section 76 [77] intends to grant to the Interstate Commerce Commission over railroad reorganization, I will say that it is the intent of the drafters of this section—which was taken from my bills H. R. 13958 and H. R. 14110—and I know the intent of the majority of the Committee on the Judiciary and the House to give the Interstate Commerce Commission *broad and complete powers in the initiation, formulation, and approval of any plan* for the reorganization of a railroad engaged in interstate commerce * * *." (76 Cong. Rec. 4130)

[2]WP Corp. main brief, p. 23. This argument seems to be echoed in the RCC main brief, p. 32.

[3]ACJ main brief, pp. 50, 51, 53-54.

rights of the parties) requires consideration of such problems is dismissed as "an attempt to read into the statute economic and political theories which were not within the contemplation of Congress"[1] and characterized as a seizure by the Commission upon a "catch phrase as an escape from the duties imposed upon it by * * * Section 77."[2]

In the light of the comment of another of the James Interests entities[3] that the intent of Section 77 was to attain "economical reorganizations entirely purged of the evils of the past as exemplified by the 1928 equity reorganization of The Chicago, Milwaukee and St. Paul Railway Company," this argument of the James Interests evidences blindness to the developing attitudes over the last two decades toward corporate reorganization problems, not only in Congress and other public regulatory bodies, but among securityholders themselves. The Debtor's reference to the 1928 *Milwaukee* reorganization doubtless had in mind the controversies as to the Commission's regulation of expenses which arose *after* the consummation of the reorganization.[4] The alleged "evils" in that reorganization against which the Commission protested had to do primarily with an alleged excess of income mortgage debt and an alleged unduly favorable treatment of old stockholders.[5]

Can there be any doubt that both the "public interest" and the "private rights" of the securityholders require that

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[1]ACJ main brief, p. 120.

[2]ACJ main brief, p. 52.

[3]Debtor's main brief, p. 21.

[4]*United States* v. *Chicago, Milwaukee, St. Paul & Pacific R. Co.*, 282 U. S. 311 (1931).

[5]*Chicago, Milwaukee & St. Paul Reorganization*, 131 I. C. C. 673 (1928), see particularly Commissioner Eastman's dissenting opinion at p. 701 *et seq.*

a new railroad corporation emerging from a Section 77 reorganization shall not start out as a financial cripple burdened with a debt structure, whether bearing interest fixed or contingent, wholly destructive of its credit and dooming it to early recurrence of bankruptcy?

As early as 1907 the Commission, in *Consolidations and Combinations of Carriers,* 12 I. C. C. 277, 306, said:

> "It is of the utmost importance, also, that railway securities should be safe and conservative investments for the public, and should yield good and ample return for the money invested. Reasonable regulation will tend to make them safer and more secure investments, and thereby benefit not only the railway companies but the public."

Section 20a of the Interstate Commerce Act was the expression of that philosophy.

Long before Section 77 was enacted the Commission, in a 1924 reorganization case, said:

> "The public interests require that, before an issue of securities by a carrier is authorized, the probability of earnings sufficient to pay costs of operation and of fixed charges be reasonably established with some surplus for dividends and other purposes."[1]

As indicated by the cited cases in footnote 1 at page 123 of the Committee's main brief, the Commission has frequently forbidden the issue of railroad securities when prospective earnings were not sufficient to justify their issue.

The necessary conclusion from the argument of the James Interests on this point is that the intent of Section 77 must have been, not to strengthen the Commission's

[1] *Denver & Rio Grande Western Reorganization,* 90 I. C. C. 141, 148.

power to prevent the creation of financial cripples in reorganization, but to weaken that power.[1]

Their argument as to the intent of Congress gains nothing from the fact that subsection (b) (4) of Section 77 expressly requires "in the light of * * * earnings experience * * * adequate coverage of fixed charges by the probable earnings available for the payment thereof," while no standard is set for contingent debt or stock, other than compatibility with the public interest. Out of an abundance of caution, Congress precisely defined the "public interest" standard to be imposed with respect to fixed charges. As to those, it requires not only some reasonable hope that they might be earned at some time in the future, but a requirement that they have "adequate coverage" and that such coverage should be determined "in the light of earnings experience." This, of course, means that Congress requires, as to fixed charges, a *past* earnings experience which demonstrates a margin of earnings reasonably sufficient to insure continuous payment of fixed charges and maintenance of the credit of the reorganized company.

The Commission has suggested no such strict standards in determining the permissible amount of contingent interest-bearing debt and stock. It has, however, sought to relate them at least to the "most optimistic estimates" of future earnings.

The James Interests, however, urge that the "public interest" in the credit of a reorganized railroad will be satisfied if only the interest upon debt, however astronomical in relation to probable earning power, is contingent, and

[1]The Commission's contrary interpretation of Section 77 on this and other questions of statutory construction of its administrative powers, as worked out in practice, is itself entitled to great weight. An illuminating analysis of this point is contained in the September, 1942, Harvard Law Review. Note, 56 Harv. L. Rev. 100, 115.

the debt maturity is postponed to the indefinite future. Quite apart from the destructive effect upon the immediate credit of any railroad so capitalized, such a capital structure would compel financing of all future capital expenditures by new fixed interest debt, for the new stock would be wholly worthless and the new contingent interest obligations wholly unsalable at any reasonable price. The seeds of future insolvency would thus be sown in the reorganization itself.

Also, quite apart from questions of "public interest," observance of the "absolute priorities" of senior creditors prevents the use of debt-overburdened capital structures in reorganization. The lack of comprehension by the James Interests on this score is evidenced by their proposal, above referred to, that the present First Mortgage Bondholders' absolute priorities should be met by the allotment for each $1,000 5% First Mortgage Bond, with accumulated interest, of a $1,000 new 4% *wholly non-cumulative* Income Mortgage Bond of 41 years later maturity. Not only would maximum annual income on the First Mortgage Bondholders' claim thus be reduced 20%, but on the earnings record of the Debtor's properties to date that diminished return would have been received in very few years and, to the extent not received in any year, would lapse. On the other hand, from the hoped for substantial earnings of 1942, and any other prosperous years, all the surplus over the diminished return to the First Mortgage Bondholders would go to junior interests.

This Court's opinions in the *Los Angeles Lumber*[1] and *Consolidated Rock Products*[2] cases negative any such treatment of the Western Pacific First Mortgage Bonds.

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[1] *Case* v. *Los Angeles Lumber Products Co., Ltd.*, 308 U. S. 106 (1939).

[2] *Consolidated Rock Products Co.* v. *Du Bois*, 312 U. S. 510 (1941).

III

The argument that Section 77 distinguishes "earning power" from "probable prospective earnings"

In determining reorganization value, subsection (e) of Section 77 requires "due consideration to the *earning power* of the property, past, present, and prospective." Subsection (b) requires that "after due consideration of the *probable prospective earnings* of the property in the light of its earnings experience * * *, there shall be adequate coverage of such fixed charges by the *probable earnings* available for the payment thereof." Upon this slight variation of language, the James Interests base an argument that by "earning power" Congress meant something entirely different from "probable prospective earnings," or "probable earnings, reasonably foreseeable."[1]

While the James Interests are ambiguous as to just what they think is the measure of "earning power," their insistence upon the constitutional inviolability of physical value as found under Section 19a of the Interstate Commerce Act gives some slight clue. Apparently they think that the "earning power," or as they put it, "capacity to earn," which determines reorganization value, is dependent solely upon the *maximum* physical capacity of the plant to transport freight and passenger traffic, at current rates and current operating expenses.[2] They would disregard

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[1]This attempted distinction runs throughout their briefs. WP Corp. main brief, pp. 7, 42, 51-53; ACJ main brief, pp. 21, 26, 46, 50, 88, 89.

[2]The argument of Mr. John L. Hall, in his brief as *amicus curiae*, filed in *In the Matter of the Chicago, Milwaukee, St. Paul and Pacific Railroad Company*, Nos. 11-19, 32, on behalf of Five Railroad Debtors in Section 77 Proceedings, expands the argu-

the absence of traffic requiring that maximum capacity, as well as its effect upon both rates and operating expenses in the hypothetical millenium when such maximum traffic shall have been attained.

It is submitted that the slight differences of wording in subsection (e) and subsection (b) support neither the distinction taken by the James Interests nor the meaning of "earning power" for which they contend.

In their stress of "earning power" or "earning capacity" as something distinguishable from "probable prospective earnings" they cite the language of this Court's opinion in the *Consolidated Rock Products* case:[2]

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ment here made by the James Interests. Mr. Hall asserts that "earning power" means "not what the Commission may expect that the road *will* earn but what the Commission thinks it *can* earn." The context indicates that the word "can" is used, not in any relation to the realities, but as a synonym of "may," indicating the constitutional minimum below which earning power may not be regulated by reduction of rates. Indeed, in this expanded argument even current rates are irrelevant: "It does not depend upon the rates currently in effect. * * * The temporary existence or absence of competitive forms of transportation does not necessarily affect earning power, though it may affect earnings for the time being" (pp. 39-40). Thus put, the argument that "earning power" is not the same as "probable prospective earnings" as a test of reorganization value is nothing but a more involved way of stating the old contention that physical value as determined under Section 19a is reorganization value.

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[1]ACJ main brief, p. 38.

[2]*Consolidated Rock Products Co.* v. *DuBois*, 312 U. S. 510, 525 (1941).

> "Findings as to the *earning capacity* of an enterprise are essential to a determination of the feasibility as well as the fairness of the plan of reorganization."

Did this Court intend to express some different standard when, in the sentence immediately succeeding that quoted by the James Interests, it said:

> "Whether or not *the earnings may reasonably be expected* to meet the interest and dividend requirements of the new securities is a *sine qua non* to a determination of the integrity and practicability of the new capital structure. It is also essential for the satisfaction of the absolute priority rule * * *."

IV

The argument that the physical value of the Debtor's properties as determined under Section 19a of the Interstate Commerce Act is constitutionally protected against foreclosure in a Section 77 reorganization

This argument runs through all the briefs, not only of the three James Interests,[1] but also of RCC.[2]

The respondents apparently do not recognize any such thing as "reorganization value," as contrasted with "physical value on the basis of reproduction cost less depreciation." As pointed out in the Committee's main brief,[3] their insistence upon the controlling effect of such physical value in determining both the problems of public interest and the rights of the present securityholders in a reorganization is due to their misconception that the term "value" has the same meaning for all purposes.

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[1]Debtor's main brief, pp. 23-29; ACJ main brief, pp. 9, 69, 88, 101; WP Corp. main brief, pp. 48-50.

[2]RCC main brief, pp. 30, 36.

[3]Pages 35-41.

The defect in the respondents' reasoning is patent from its very expression as found in the RCC main brief,

> "* * * the valuation of a railroad * * * pursuant to the provisions of Section 19a is the value upon which the owners of the railroad property are entitled to earn, *if they can*, a fair return, and * * * this value cannot be taken away from them excepting by judicial decree."[1]

All the respondents quite overlook that significant condition, *"if they can."* In the last twenty years the Western Pacific properties have had sufficient earnings to pay the contractual interest upon the aggregate claims of its secured creditors as of January 1, 1943,[2] in but one year (1926), and then only at the expense of substantial under-maintenance. In the cold light of that fact, it is no solace to the Western Pacific First Mortgage Bondholders that the Western Pacific has a fine plant, capable of handling a volume of traffic even in excess of that being handled in 1942.

Nor does the Committee believe that it is consistent with the recognition of the "absolute priorities" of the First Mortgage Bondholders, that they should be required substantially continuously to forego interest upon their investment in order to prevent foreclosure or cancellation of the equity of stockholders who provided a plant of such maximum capacity that only sporadically, if ever, could that capacity be actually employed. That, however, is the conception which the James Interests express of the relative

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[1]RCC main brief, p. 30.

[2]As of that date, the aggregate secured claims, including accumulated unpaid interest, will exceed $100,000,000.

rights of the Western Pacific First Mortgage Bondholders and the junior interests.[1]

The unsecured debt and stock claim of WP Corp., as well as a substantial part of the claim represented by the ACJ Notes, "have no value," not because of any "administrative *fiat*" of the Commission, but because the Western Pacific properties have failed to evidence any "power" or "capacity," "past, present, or prospective," actually to earn the moneys necessary to service the senior First Mortgage Bonds. After more than nine years of default upon that senior debt, there is no longer any "equity" to delay the "foreclosure and cancellation" of the valueless junior interests.

The accomplishment of that "foreclosure" does not, as RCC insists,[2] require a sale by foreclosure pursuant to a judicial decree *in an equity proceeding;* nor is this, as stated by RCC, "a reorganization of a company not found to be insolvent." This is a proceeding for dealing with a property found by the Commission, in every substantive sense and upon conclusive evidence, to be insolvent by more than $11,000,000.[3] It is also a judicial proceeding which contemplates ultimate foreclosure of valueless interests "by judicial decree." As will later be pointed out in this reply brief (Point XIV), the Commission Plan expressly pro-

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[1]ACJ main brief, pp. 47-48, 52, 69-71; Debtor's main brief, pp. 23, 31; WP Corp. main brief, pp. 7, 24-25, 51-53.

[2]RCC main brief, p. 30.

[3]The difference between the total secured and unsecured debt of the Debtor at January 1, 1939, in the amount of $95,733,029.75 (see the Committee's main brief, p. 5) and the Commission's reorganization value of the Debtor at not more than $84,027,559 (see the Committee's main brief, pp. 55 and 76).

vides for this foreclosure by a conventional sale allowing the foreclosed dissenting interests to realize, if they can, cash proceeds for their interests.

This Court's decision in the *Radford* case[1] not only affords no defense to such a foreclosure,—it establishes the First Mortgage Bondholders' right to such a foreclosure. There this Court was dealing with an attempt "to abridge, *solely in the interests of the mortgagor,* a substantive right of the *mortgagee* in specific property held as security," and this Court denied the effectiveness of the attempt. Here, too, a mortgagor (the James Interests) and a junior creditor (RCC) are again seeking to abridge, solely in their own interests, rights of the senior First Mortgage Bondholders.

V

The argument that the Commission failed to give consideration to the Debtor's system "as it exists today"

The James Interests insist that the Commission dealt only with "the earnings of the property of the debtor as that system existed prior to the changes made from 1927 to 1938."[2] This is perhaps another form of the argument which still continues in the James Interests briefs that the Commission Plan gives weight only to depression earnings.[3]

The Committee wholly agrees that depression earnings are not controlling, and that the Commission Plan must be

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[1] *Louisville Joint Stock Land Bank* v. *Radford*, 295 U. S. 555 (1935), cited in ACJ main brief, p. 39, and in WP Corp. main brief, p. 16.

[2] ACJ main brief, p. 21.

[3] WP Corp. main brief, pp. 43, 53; Debtor's main brief, p. 31.

tested by the facts of today, not merely by those of 1939, when it was approved by the Commission.

That the capitalization under the Commission Plan cannot be sustained on the basis of depression earnings and that it can be supported only by a most optimistic view of probable prospective earnings, is conclusively established by the charts appearing opposite pages 58 and 59 of the Committee's main brief and by the rates at which the Commission Plan capitalized average earnings for various past periods, including the period from 1939 to 1941, as shown on page 60 of the Committee's main brief.

The James Interests argument, however, now takes the form that the Commission failed to take into consideration, or at least to give any weight to, increased earning power due to the Northern California Extension (completed in 1931), the Dotsero Cut-off (a part of the lines of the Denver & Rio Grande, completed in 1934), or the rehabilitation program (completed in 1938).

Substantial evidence as to all three of the factors mentioned by the James Interests was incorporated in the record.[1] The evidence, as well as the possible effect of all three factors upon the "probable prospective earnings reasonably foreseeable," was fully discussed in the Commission's Report expressing the "reasons for its conclusions."[2]

So impressed was Commissioner Eastman with the weight which the Commission had given to the Northern California Extension in the development of the Commis-

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[1]R. 1942-48, 2094-98, 1939, 2099-2100, 1985-86, 2145-52, 2172-85, 2225-33.

[2]R. 203, 207-8, 212, 214-15.

sion Plan that, testifying as Chairman of the Commission in 1939 before a House subcommittee,[1] he said:

> "I will give as an illustration the case of the Western Pacific. There was evidence in the *Western Pacific* case that the recent opening of the new line to the north in connection with the Great Northern Railway [the Northern California Extension] had increased traffic and revenues, and that this increase was likely to continue for the future. In other words, there was evidence of the introduction at the end or toward the end of the period of 12 years of a new factor consisting of the opening of a new line with an actual demonstration of its traffic possibilities. That would, I think, be evidence tending to rebut the presumption with respect to the average earnings for the 12 years."

The Commission of course gave to the Northern California Extension no such weight as the James Interests seek to deduce from the figures appearing on page 28 of the ACJ main brief. Their conclusion from those figures is that the Northern California Extension has made a 26% additional contribution to the gross revenues of the system and that "if one were to project back to the pre-depression years a 26% contribution to gross from a part of the debtor's system which did not then exist, a quite different historical earnings' picture would be presented."

It will be noted that the figures used to support this claim attribute to the gross revenues of the Northern California Extension *all* gross revenues received by the Debtor

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[1]Transcript of hearings before Judiciary Committee on S. 1869 (76th Cong., 2nd Sess., 1939) 552-3.

from hauling over *any part* of the Debtor's system any freight which originated on or terminated on or passed over the Northern California Extension. In other words, if a ton of freight moved on the Northern California Extension from a point five miles distant from its connection with the Debtor's main line at Keddie, California, and then moved either 647 miles eastward to Salt Lake City or 281 miles westward to San Francisco over the Debtor's main line, *all* gross revenues received by the Debtor from the haul are attributed in the ACJ computation to the Northern California Extension. Undoubtedly a substantial part of such traffic does result from the Extension. On the other hand, undoubtedly a substantial part would be available to the Debtor even if it had not built the Extension.

Admittedly, the Northern California Extension is a valuable addition to the Debtor's properties, as those properties existed prior to *1932*. There is, however, no evidence whatsoever that it has increased, or will ever in the future increase, by 26%, the gross earnings of the Debtor's properties. Whatever may be the probable beneficial effect of the Extension, it was expressly appraised by the Commission, as an expert in such matters, and adequate effect given in the optimistic capitalization provided by the Commission Plan.

VI

The argument that in the twelve months ending July 31, 1942, the Debtor's properties earned "available for interest, a sum sufficient to cover its old fixed charges more than twice"

The ocular demonstration of the optimism of the Commission Plan capitalization, furnished by the charts inserted

opposite pages 58 and 59 of the Committee's main brief, is sought to be answered by the argument:

> "no amount of skillful argument or chart-making can cloud or conceal the fact that during the twelve month period from August 1, 1941 to July 31, 1942, as shown by the earnings statements filed by the Trustees in this proceeding pursuant to the order of the District Court and before this Court by stipulation, the debtor's railroad system earned $7,987,512 *available for interest, a sum sufficient to cover its old fixed charges more than twice.*"[1]

This Court must have been struck with the disparity between the earnings "available for interest" for 1940 and 1941, as stated on page 7 of the Committee's main brief and in the charts already referred to, and the earnings for the same years as stated in the ACJ main brief at page 24, the WP Corp. main brief at page 58 and the Debtor's main brief at page 32.

As explained in the Committee's main brief, the earnings stated by it for the years 1940 and 1941 take into account deductions for Federal income taxes (but not possible excess profits taxes) which would have been imposed had the Commission Plan been effective according to its terms. The footnote on page 7 of the Committee's main brief states the earnings after deduction of Federal income taxes, even on the basis of the Debtor's existing capitalization.

The figures stated in all the James Interests briefs do not make necessary adjustments, even for Federal income taxes under the laws applicable to those years upon a capital structure equal to that of the Debtor's present capital struc-

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[1]ACJ main brief, p. 25.

ture. The earnings, therefore, which the James Interests briefs describe as "available for interest" are in fact earnings available for *Federal income taxes and excess profits taxes* and for fixed charges.

Furthermore, in stating that the $7,987,512 of earnings for the twelve months ending July 31, 1942, constitutes "a sum sufficient to cover its old fixed charges more than twice," the James Interests compute "old fixed charges" in disregard of more than nine years of unpaid interest accumulated upon *all* the Debtor's existing obligations. The principal amount of obligations upon which "fixed charges" are contractually payable by the Debtor today exceeds by nearly 50% the amount upon which the James Interests base their computation.

If, therefore, the figures used by the James Interests are restated so as not to "cloud or conceal the facts" of (1) omission to take into account Federal income and excess profits taxes (of the probability of which this Court will surely take judicial notice), and (2) omission of accrued unpaid interest upon which the Debtor is contractually liable for fixed interest, the "wide margin" by which the James Interests assert that the Debtor's system earned "its interest requirements under its existing capitalization" will vanish.[1]

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[1]Within the last month two additional courts have realistically declined to be swayed by a debtor railroad's "war boom" revenues. *Guaranty Trust Co.* v. *The Minneapolis & St. Louis R.R.* (D. C. Minn., September 10, 1942, not yet reported); *In re Alabama, Tenn. & Mo.* (S. D. Ala., September 15, 1942). For discussion of this subject, see Committee's main brief, pp. 61-68.

VII

The argument that the Commission made no specific finding, in terms of dollars, of the earning power or of the value of the Debtor's properties either as an entirety or in respect of separate mortgaged segments

Admittedly, the Commission made no such precise valuations in formal findings. Nor did the Commission make any formal finding that the Debtor is insolvent. However, as pointed out in the Committee's main brief,[1] the Commission, in every substantive sense, did find that the properties of the Debtor as an aggregate had a reorganization value of less than $84,027,559 and therefore that the Debtor's financial condition was approximately $4,000,000 below the aggregate of its secured debt and more than $11,000,000 below the level of solvency. On the latter question, the Commission also specifically found not only that the Debtor's stock "has no value," but that its unsecured debt "has no value."

In the light of these findings and the Commission's elaborate statement of "its reasons for its conclusions," it is idle pretense for the James Interests to protest that their objections to the Commission's Reports and Orders in connection with the Commission Plan do not go to the form of the Commission's findings.[2]

They argue that "capitalization" is not necessarily synonymous with "valuation."[3] Of course. But the method by which the Commission built up the capitalization contemplated by the Commission Plan and then distributed it among the participating creditors in observance of their

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[1]Pages 55 and 76.

[2]WP Corp. main brief, p. 28.

[3]WP Corp. main brief, pp. 32-34; ACJ main brief, pp. 55-58.

"absolute priorities" did, in every substantive sense, fix a value for reorganization purposes for the Debtor's properties.

In this connection the James Interests[1] purport to find a fatal inconsistency in the fact that the Commission Plan allots to the senior First Mortgage Bonds new no par value Common Stock at $57 a share, whereas, in order to fill out the RCC claim in full, no par value Common Stock allotted to RCC would have to be taken at $62 per share. The inconsistency which the James Interests purport to find does not exist. The RCC claim, being junior to that of the First Mortgage Bonds, must, to the extent which it is allotted the same class of new securities as are allotted for the senior First Mortgage Bonds, take those securities upon terms less favorable than those given the senior First Mortgage Bonds.[2]

To give emphasis to their insistence upon precise dollars and cents valuations, the James Interests assert:

> "That the language of those who have negotiated reorganizations has always been, of necessity, one of dollars and cents, just as is the language of business generally, is brushed aside by counsel for the petitioners."[3]

In no railroad reorganization with which the Committee counsel has had any contact, or of which he has been informed during more than thirty years' experience in the problems of railroad reorganization, has either aggregate capitalization or distribution been based upon con-

[1]WP Corp. main brief, p. 34; ACJ main brief, pp. 57-58.

[2]*Kansas City Terminal Ry.* v. *Central Union Trust Co.*, 271 U. S. 445 (1926); *Case* v. *Los Angeles Lumber Products Co., Ltd., supra; Consolidated Rock Products Co.* v. *Du Bois, supra.*

[3]ACJ supplemental answering brief, dated October 9, 1942, erroneously labeled "Reply Brief," p. 15.

sideration of dollars and cents values of properties, old securities, or new securities. In all such cases, and in every railroad reorganization case before the Commission or the courts which the Committee counsel has been able to find, the factors considered have been those of aggregate earning power, and relative earning power of the various mortgage divisions. Reorganizers, whether in the old equity days or under Section 77, have never deluded themselves by attempting the impossibility of reducing old securities and new securities to a deceptive common denominator, expressed in dollars and cents.[1] The only two exceptions to this practice have been, as indicated in the Committee's main brief,[2] (1) in the case of old securities having security capable of ready liquidation for cash, particularly if in an amount exceeding the amount of the claim, and (2) in the case of a sale of new securities in the reorganization to provide new money.

VIII

The argument that the Commission Plan is "the most drastic plan ever proposed for a major property"

The Debtor's main brief characterizes the Commission Plan for the Western Pacific as with "one exception," the "most drastic plan ever proposed for a major property."[3]

The Commission has formulated plans of reorganization for eleven other major Class I carriers; three of these plans have been consummated, the remainder being in various stages of the procedure prescribed by Section 77.

Applying reported earnings of those carriers for the years 1923 to 1939, inclusive, to the new capitalizations

[1]See particularly the comments of the Court in *Guaranty Trust Company* v. *Missouri Pacific Ry. Co.*, 238 Fed. 812, 818 (E. D. Mo. 1916).

[2]Pages 85-86.

[3]Debtor's main brief, p. 22.

	West. Pac.	C. & E. I.[1]	C. G. W.[1]	C. & N. W.[1]	C. M. St. P. & P.[2]	C. R. I. & P.	Erie[1]	Mo. Pac.[2]	New Haven[2]	Frisco[2]	Cotton Belt
1923.....	$ .85	$ 8.70	$ 1.54	$ 4.54	$ 2.88	$ 3.79	$10.98	$ .12(D)	$ 8.09	$16.80	$18.55
1924.....	.32	2.17(D)	2.07	4.39	2.27	5.61	12.59	5.10	16.48	21.10	13.74
1925.....	3.71	1.83	2.26	6.16	1.34	6.19	9.61	6.52	22.52	23.12	13.90
1926.....	4.19	4.53	3.71	7.50	2.05	8.93	12.64	7.59	22.07	24.37	13.97
1927.....	1.15(D)	3.19	.90	5.97	.09	9.78	6.27	4.06	20.45	24.27	11.95
1928.....	.24(D)	2.96	3.99	8.01	7.24	10.18	12.05	8.49	27.65	26.94	10.29
1929.....	1.60(D)	3.32	5.77	11.20	6.59	10.78	13.57	11.55	34.48	23.81	6.73
1930.....	4.66(D)	44.11(D)	5.84	7.33	1.87	7.50	7.57	7.19	24.32	15.91	.38(D)
1931.....	10.11(D)	20.65(D)	4.08	5.71(D)	2.21(D)	2.78	2.42	3.61	14.75	3.49	1.38
1932.....	8.73(D)	18.91(D)	8.22(D)	9.74(D)	6.64(D)	3.45(D)	.56	5.16(D)	1.19	7.22(D)	13.75(D)
1933.....	7.42(D)	10.66(D)	3.30(D)	4.24(D)	2.48(D)	4.05(D)	4.21	6.00(D)	5.17(D)	7.58(D)	3.26(D)
1934.....	6.13(D)	8.02(D)	3.92(D)	5.72(D)	3.38(D)	4.98(D)	2.70	6.03(D)	6.53(D)	8.63(D)	2.28(D)
1935.....	7.00(D)	7.97(D)	3.38(D)	7.56(D)	4.23(D)	6.67(D)	2.49	9.07(D)	3.63(D)	10.36(D)	1.30
1936.....	8.96(D)	1.59(D)	1.66	6.09(D)	1.97(D)	5.41(D)	5.45	3.11(D)	5.08(D)	4.37(D)	4.70
1937.....	12.35(D)	3.61(D)	5.80(D)	10.83(D)	2.45(D)	3.15(D)	2.72	2.14(D)	11.20(D)	4.83(D)	.78(D)
1938.....	13.42(D)	7.45(D)	7.41(D)	11.29(D)	4.20(D)	4.44(D)	7.55(D)	7.95(D)	17.64(D)	10.74(D)	1.94(D)
1939.....	5.19(D)	5.83(D)	1.25(D)	5.80(D)	2.63(D)	2.49(D)	.80	6.09(D)	5.53(D)	6.46(D)	6.68(D)
Average[3]..	4.47(D)	6.26(D)	.09(D)	.70(D)	.35(D)	1.82	5.83	.50	8.07	7.10	3.97

[1]Plan approved by District Court. The C. & E. I., C. G. W., and Erie Plans have been consummated, and the C. M. St. P. & P. Plan has been rejected by the Circuit Court of Appeals for the Seventh Circuit on the ground of inadequate findings by the Commission. See Committee's main brief, p. 69, note 1, and p. 90, note 1.

[2]Set aside by the District Court on the ground of undue preference to certain classes and inadequate treatment of other classes of securityholders. See Committee's main brief, p. 133, notes 1 and 2.

[3]In this computation averages have been obtained by adding all the earnings, and subtracting all the deficits, for the years 1923 to 1939, inclusive, and dividing the result by 17.

(D) denotes deficit.

proposed in those plans (with one exception for which figures are not available) and to that proposed by the Commission Plan for Western Pacific, the earnings per share on the new common stock of the reorganized companies would be approximately as appears on the opposite page.[1]

It will thus be seen, not only that the Western Pacific Plan is *not* the most drastic of the various railroad reorganization plans formulated by the Commission, but that on the contrary, save for the C. & E. I. Plan, it is the most liberal of such plans. That the Western Pacific Plan errs, if anything, on the side of undue optimism and is out of line in that respect with other plans promulgated by the Commission, has been pointed out in an analysis of the Commission's plans in the Harvard Law Review.[2]

The figures[3] upon which the Debtor relies for its contrary assertion have to do with the relationship of prescribed annual charges through Preferred Stock dividends to the entire authorized capitalization, taking no par value Common Stock at $100 per share. This relationship is wholly irrelevant to the question of liberality or lack of liberality of the aggregate capitalization. The absurdity of the Debtor's argument becomes the more apparent when it is realized that if, as the Debtor urges, the aggregate capitalization were increased by the addition of substantially more no par value Common Stock, the percentage relationship stated by the Debtor would become even lower, and hence, by the Debtor's reasoning, the aggregate capitalization even "more drastic" in comparison with the capitalization under other plans promulgated by the Commission.

[1]In this computation, earnings applicable to sinking funds and capital funds are treated as redounding to the benefit of the Common Stock; which of course they ultimately do, and the Common Stock (if allocated on a basis other than $100 per share) is adjusted to a $100 per share basis.

[2]Note (1941) Harv. L. Rev. 653, 657.

[3]Debtor's main brief, p. 22, note 27.

IX

The argument that the treatment of the Trustees' Certificates and the RFC Notes violates the Reconstruction Finance Corporation Act

All of the arguments on the merits made by the various respondents against the Commission Plan's treatment of the Trustees' Certificates and the RFC Notes have, it is believed, been anticipated by the Committee's main brief[1] and by the RFC main brief.

The James Interests assert two alleged defects in the power of RFC to acquire the new securities provided for it under the Commission Plan, first, because the Commission will be unable to find as a matter of law that funds are not available to the Trustees or the Reorganized Company on reasonable terms through private channels, and, second, because RFC will be receiving an illegal fee or commission by consummating the exchange.[2]

The paragraph of Section 5 of the RFC Act which applies to railroads is reprinted as Appendix A hereto. A reading of that paragraph in its entirety makes it apparent that the requirement that funds be not available on reasonable terms through private channels applies only to *loans* made by RFC and not to the refunding by the RFC, as part of a reorganization plan, of outstanding *obligations* held by it.

Even in the case of a loan, the statute and the decisions of the Commission make it clear that the determination of whether funds are available on reasonable terms through private channels lies exclusively with RFC. The statutory

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[1] Pages 107-13.

[2] ACJ main brief, pp. 117-18.

requirement is that RFC may make loans to railroads "* * * when, *in the opinion of the Corporation,* funds are not available on reasonable terms through private channels * * *." On numerous occasions, the Commission has said:

> "* * * It is our view that the question of the ability of the applicant to obtain funds upon reasonable terms through banking channels or from the general public is committed by Section 5 of the Reconstruction Finance Corporation Act primarily to the corporation."[1]

Even if the Commission were required to go into the question as to whether, in the present case, funds are available on reasonable terms through private channels, it would have to take into account, as one of the factors affecting the problem, all the necessities of the reorganization. That $10,000,000 could not be provided on a long-term basis through private channels on terms as favorable as the provisions of the Commission Plan was conclusively established at the hearing before the District Court on January 22, 1940,[2] and again at the hearing before the District Court on the ACJ motion (see *infra,* pp. 29-30).

Equally untenable is ACJ's second contention that the Commission Plan is illegal in its treatment of RFC because the grant of preferential treatment to the RFC Notes in consideration of the exchange of the Trustees' Certificates for the less valuable new First Mortgage Bonds constitutes an illegal fee or commission. This contention

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[1] *Alton R. Co. Reconstruction Loan,* 184 I. C. C. 458, 459 (1932); *Chicago, R. I. & P. Ry. Co. Reconstruction Loan,* 184 I. C. C. 597, 600 (1932); see also *Chicago & E. I. Ry. Co. Reconstruction Loan,* 180 I. C. C. 639, 643 (1932); *Missouri Pacific R. Co. Reconstruction Loan,* 184 I. C. C. 3 (1932).

[2] R. 1530-1567.

is inspired by the following provision of Section 5 of the RFC Act:

> "* * * Provided, That no fee or commission shall be paid by any applicant for a loan under the provisions hereof in connection with any such application or any loan made or to be made hereunder, and the agreement to pay or payment of any such fee or commission shall be unlawful. * * *"

That proviso is not only by its terms inapplicable here, but the express intent of Congress further demonstrates how far afield the ACJ argument has gone.[1]

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[1]Representative Rayburn, who offered the amendment containing the proviso, explained his amendment on the floor of the House as follows:

> "* * * this amendment means simply this and nothing else, * * *
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> * * * * * * * * * *
>
> "* * * We have a great many ex-Congressmen, a great many ex-Senators, a great many ex-members of boards and commissions who have opened up law offices in Washington. We have many ex-attorneys for these boards and these commissions with offices in Washington. What they do is to go out and, by a campaign, convince these people, who are going to get money from these departments, or these bureaus, or these commissions, that the only way they can get it is to pay them 10 per cent. of the amount or more. * * *
>
> "The Interstate Commerce Commission is called upon in this bill to recommend and approve an application by a railroad for a loan under its provisions. Before the Interstate Commerce Commission, which is supposed to know all about these matters and is supposed to go into them minutely, approves a loan of $1,000,000 or $2,000,000, or any amount, they want to believe that when they approve it and when the money is paid over, the railroad that is in such distress will get all of it and not that some attorney or some ex-commissioner, or some ex-attorney for a board, or something like that will get 10 per cent. or 20 per cent. of the original amount." (75 Cong. Rec. 2101-2)

No elaboration on this explanation seems necessary to demonstrate the complete inapplicability of this provision to the facts of the present case.

A factual misstatement in the RCC main brief with respect to the treatment of the RFC claim should be called to the Court's attention. On page 14 that brief sets forth all the new securities allocated to RFC, RCC and ACJ, including, in the case of those allocated to RFC, the new Income Mortgage Bonds and Preferred Stock *expressly allocated as consideration for the RFC's exchange of Trustees' Certificates* for First Mortgage Bonds. In other words, the RCC table is not confined to the new securities allocated to the Refunding Mortgage Bonds pledged for the RFC, RCC and ACJ Notes.

In the table set forth on its page 13, the RCC main brief allots all these new securities among the RFC, RCC and ACJ Notes (again including those specifically allocable against the discount on the new First Mortgage Bonds accepted for the Trustees' Certificates) as if all these new securities had been allocated by the Commission Plan against the pledged Refunding Mortgage Bonds.

Neither RCC nor ACJ has ever offered to provide any part of the $10,000,000 in substance provided by RFC to refund the Trustees' Certificates. What possible basis, therefore, is there for them to share in the consideration paid to RFC for furnishing the $10,000,000 new money?

Three times the James Interests, sometimes seconded by RCC, have endeavored to render the Commission Plan nugatory by forcing the application of cash in the hands of the Reorganization Trustees to the payment of the Trustees' Certificates. Such use of cash resulting from earnings since the effective date of the Commission Plan might not only destroy the basis for the treatment of the RFC Notes under the Commission Plan, through retirement of the Trustees' Certificates, but it would also denude the estate of the cash necessary to service the new securities since January 1,

1939, the effective date of the Commission Plan. The District Court denied the first two attempts.[1] The latest effort of the James Interests to this end is pending in the District Court and is now set for hearing on November 2, 1942.[2]

The Reorganization Trustees' petition, upon which that hearing is to be had, is before this Court as Appendix A to the RCC main brief. It is quoted by RCC (at p. 19) as stating "that they have $6,000,000 of cash deposited with the RFC and expect to have six million more on hand on December first, at which time they can, *without impairing in anywise the reorganization*, pay off a substantial portion of the Trustees' Certificates."

The Trustees said no such thing. What they said was that they were of opinion "that they would be able, *without impairment of necessary working capital and without prejudice to the conduct of the railroad business of the Debtor*,"[3] to retire a substantial portion of the Trustees' Certificates. In other words, the Trustees said only that if they entirely disregarded all the requirements of the reorganization, they could pay a substantial part of the Trustees' Certificates.

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[1]Orders dated May 13, 1941, and November 26, 1941. See also *In re Western Pacific R. R.*, 38 F. Supp. 877 (N. D. Calif. 1941).

[2]The James Interests have objected to the Reorganization Trustees' acceptance of an offer of RFC to carry the Trustees' Certificates after their maturity December 1, 1942, under an arrangement that default may be declared only upon four months' notice and that the Trustees may continue to reduce the net interest payable in respect of the Trustees' Certificates by increasing their time deposits with RFC (now $6,000,000), on which RFC will allow the same rate of interest as that borne by the Trustees' Certificates (4%). This, of course, means that if the Trustees so deposited an amount equal to the face amount of the outstanding Trustees' Certificates, the latter would entail no interest charge.

[3]RCC main brief, pp. 45-46.

X

The argument that the relationship between the accommodation pledgors and the accommodation pledgees should be dealt with in the Commission Plan

The Debtor makes a new argument[1] for the benefit of the two other James Interests entities who furnished the Debtor, as an accommodation, some of the collateral pledged to secure the RFC and RCC Notes. Its argument is that, because the loan of the accommodation collateral by ACJ and WP Corp. made the accommodation pledgors creditors of the Debtor in respect of the accommodation pledge, the Commission Plan should deal with the entire problem of the accommodation collateral.

This argument, perhaps plausible at first blush, confuses the various relationships created by the accommodation pledges.

Included in the accommodation collateral were $2,000,000 Refunding Mortgage Bonds, pledged by ACJ to secure the RCC Notes. The accommodation pledge of those Bonds created these relationships:

> (1) RCC's right against the Debtor's property as pledgee of the pledged Bonds. This relationship is dealt with by the Commission Plan, which allocates to the RCC Notes the new securities allocated to the pledged Bonds.
>
> (2) ACJ's right against the Debtor for exoneration and indemnification in respect of the accommodation pledge. This relationship created a contingent

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[1]Debtor's main brief, pp. 14-17.

unsecured claim by ACJ against the Debtor, and the relationship is dealt with by the Commission Plan in its finding that the unsecured debt "has no value" and is not entitled to participation under the Commission Plan.

(3) ACJ's right to compel RCC to marshall by going first against the non-accommodation collateral and then against the accommodation collateral to the extent of any remaining deficiency. This is a relationship entirely between ACJ and RCC and cannot be dealt with in the Commission Plan, on the merits.

The latter proposition is not changed by the fact, adverted to by the Debtor,[1] that the Committee, as part of the compromise proposals and in order to secure some reorganization plan acceptable to the James Interests (the accommodation pledgors), suggested that the accommodation pledgees agree to return the accommodation collateral to the accommodation pledgors.

Most of the accommodation collateral, however, consists of securities, the property of WP Corp., which are not claims against the Debtor or its estate. The accommodation pledge of this collateral did not create relationships of the character described in the foregoing subparagraph (1). As a result of the accommodation pledges, WP Corp. has its unsecured claim for exoneration and indemnification against the Debtor, found valueless by the Commission Plan. The existence of that relationship cannot make the relationships between the accommodation pledgees, RFC

[1]Debtor's main brief, pp. 15-16.

and RCC, on the one hand, and the accommodation pledgor, WP Corp., on the other hand, a proper subject matter for the Commission Plan, in the *absence* of a compromise agreement by all the parties concerned.

XI

The argument that the new evidence before the District Court respecting Central California Traction and Alameda Belt properties required a change in the allocation of new securities against those properties

The Refunding Mortgage Trustee is correct in stating that new evidence with respect to the allocations against the Central California Traction and Alameda Belt properties was introduced before the District Court.[1] That evidence had to do largely with additional studies of the traffic contributed by those two properties to the Debtor's directly owned lines.[2]

However, like the James Interests analysis of the contributions of the Northern California Extension,[3] those studies attributed to the two properties all the gross revenues realized by the Debtor from all the haulage on Debtor properties of every ton of freight which originated on or terminated on or was carried over either of the two properties. The result was that the gross revenues from a ton of freight originating on one of the properties and terminating on the other were taken into the so-called contributed traffic studies twice. Of course on any such basis various

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[1]Refunding Mortgage Trustee's answering brief, p. 6.

[2]R. 1098-1106, 1309-17.

[3]ACJ main brief, p. 28. See p. 17, *supra*.

terminal and branch lines would soon pile up gross revenues materially exceeding those of the whole system.

The Refunding Mortgage Trustee's brief concedes that the Debtor has continually been compelled to contribute cash to these properties, both for operating deficits and for capital purposes.[1]

While the Commission found that they had "no material value," the Commission did give them recognition by allotting to the Refunding Mortgage Bonds all the Common Stock remaining after providing for the absolute priorities of the First Mortgage Bondholders.

Only by attributing the Common Stock allotted to the Refunding Mortgage Bonds against such residual values in the Refunding Mortgage property can the allotment of Common Stock to those Bonds under the Commission Plan be sustained.

XII

The argument that the Reorganization Committee contemplated by the Commission Plan should be eliminated and the reorganization carried out solely by the Debtor

We cannot believe that this Court would regard as proper administration any procedure which left the determination of all the problems involved in consummating the reorganization to *this* Debtor. Its interest in its properties the Commission has found to be of "no value," it is controlled by those whose interests conflict with those of the senior creditors, and it has demonstrated throughout this proceeding a consistent hostility to the First Mortgage Bondholders.

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[1]Refunding Mortgage Trustee's answering brief, pp. 9-10.

In any event, this problem is clearly a matter of administration within the discretion of the Commission. Notwithstanding that the Committee expressed, before the Commission, its entire willingness that the representative of the First Mortgage Bonds on the Reorganization Committee be elected by First Mortgage Bondholders, the Commission provided that one of the three Reorganization Managers should be designated by the Committee. The experience of the First Mortgage Bondholders which the Committee represents, it is submitted, justifies the Commission's confidence in it.

The Committee is, as urged by the Debtor, merely a group organized under subsection (p) of Section 77, and does not purport to act for any of the First Mortgage Bondholders who are not members of the group. It therefore does not purport to represent any of the $32,348,700 of First Mortgage Bonds which the Debtor asserts are "wholly unrepresented * * * except as they may be represented either by the mortgage trustees * * * or by the Debtor."[1] Certainly the Committee does not represent any of the $8,000,000 of First Mortgage Bonds held by the James Interests.[2] The Committee, however, has no conflicting interests, and it believes that its views regarding the rights of the First Mortgage Bondholders, with which the First Mortgage Trustees have been in entire accord, more probably represent the views of the holders of the $22,000,000 of First Mortgage Bonds who have not appeared in the proceeding than do the views of the Debtor.

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[1]Debtor's main brief, p. 5.

[2]Committee counsel has been advised by ACJ counsel that these James Interests First Mortgage Bonds, which the Committee clearly does not represent, have, since the taking of the record testimony, been increased to more than $10,000,000.

XIII

The argument that the District Court failed to exercise an informed, independent judgment

The James Interests urge that "as to questions of capitalization the District Court refused to pass judgment," that "because of the District Court's misconception of its functions no adequate review of the Commission's determinations was possible," and that "the opinion of the District Court shows complete surrender to * * * the Commission, and a complete acceptance of its preliminary determination of questions relating to the distribution of the new securities."[1]

Even a superficial reading of the District Court's 31-page opinion disproves this criticism by the James Interests.

Quoting the decision of this Court in *St. Joseph Stock Yards Co.* v. *United States,*[2] the James Interests assert[3] that "the Court must make an independent determination of challenged questions of law which are involved in administrative determinations and, if necessary, must examine the entire record, including the evidence."

This the District Court did. He not only "read the record;" he heard new evidence. He not only "carefully considered all the objections" and "read the briefs of the respective counsel in support of the objections," but he wrote a careful well-reasoned opinion on the main questions raised by the objections to the Commission Plan (alleged insufficiency of capitalization) and gave reasons for his conclusions, which added materially, both by quotations of

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[1]ACJ main brief, pp. 102-3. See also WP Corp. main brief, pp. 14, 18.

[2]298 U. S. 38 (1936).

[3]ACJ main brief, p. 111.

legal authority and by factual analysis, to the reasons given by the Commission.

Does the fact that after this examination of all the record, including participation in the making of a part of it, and this examination and exposition of law, the District Court was "wholly in accord" with all the conclusions reached by the Commission, evidence a lack of either independence or information in the reaching of that judgment?

To be sure the District Court did in a *dictum* discuss the relative functions of the Commission and the Court in language criticized by the Circuit Court of Appeals. That the proper determination of these relationships by this Court is sought by all the parties before this Court cannot change the fact, pointed out in the RFC main brief,[1] that the discussion was only a *dictum*. The District Court did independently determine all the disputed questions.

The following language used in this Court's opinion in the *St. Joseph Stock Yards* case[2] is therefore pertinent:

> "As the District Court, despite its observation as to the scope of review, apparently did pass upon the evidence, making findings of its own and adopting findings of the Secretary, we do not think it necessary to remand the cause for further consideration * * *."

XIV

The argument that the Commission Plan will be rendered nugatory by its rejection by the James Interests and RCC

The Committee agrees with the James Interests that when the Commission Plan comes before the District Court

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[1] Pages 86-88.
[2] 298 U. S. 38, 54 (1936).

for confirmation the James Interests and RCC will be entitled, as will also be the supporters of the Commission Plan, to make a further record. In the light of that record the District Court will again have to be "satisfied" and find that the Plan "makes adequate provision for fair and equitable treatment for the interests or claims of those rejecting it." Undoubtedly the James Interests will endeavor at that hearing to establish their present contention that the present high earnings of the Western Pacific are largely due to factors not related to the war effort,[1] but apparently to the perpetual elimination of such adverse competition as that of the Panama Canal and, presumably, trucks, busses and airplanes. Perhaps, too, if they are overruled they will carry out their threat to vote to reject the Commission Plan.[2]

But, to paraphrase what this Court said in another connection, "there is no necessity for this Court to yield to such pressures" in the proceeding immediately before it. The question now is whether, upon the record before the Court and all additional facts of which the Court may properly take judicial notice, the Court should affirm the District Court's approval of the Commission Plan in order to permit the taking of the next step in the reorganization procedure.

The Court cannot now determine all the issues which the ingenuity of the James Interests counsel will undoubtedly develop when the District Court shall enter its confirmation order. The Court can, however, by its present opinion, eliminate, not only for the *Western Pacific* case but for the other pending railroad reorganizations, a multitude

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[1]ACJ main brief, p. 26; Debtor's main brief, pp. 33-36; WP Corp. main brief, pp. 58-59.

[2]ACJ main brief, p. 6.

of arguments raised by objectors to the Commission plans which, it is believed, the Committee briefs in this proceeding demonstrate are wholly inconsistent with this Court's past decisions.

The Commission Plan itself contains adequate provision for dealing with those classes of creditors who may ultimately reject it, notwithstanding a finding of the District Court that it is fair and equitable.

That the James Interests would never cease their efforts to defeat the Commission Plan was foreseen both by the Committee and by the Commission. The Commission Plan therefore contains a provision which obviates any question as to whether the so-called "cram down" provision of Section 77, permitting the District Court to require dissenting classes to accept new securities found to be fair and equitable, constitutes due process, without a sale to insure a cash alternative. The Commission Plan provides that it may be consummated through the device of a sale at an upset price fixed by the District Court.[1] This provision, as already pointed out,[2] adequately takes care of the contentions of the James Interests and RCC that their rights cannot be foreclosed "without judicial decree" or the conventional foreclosure sale.

Of course such a sale is not a substitute for findings that the plan is "fair and equitable." But the presence of such a provision, under the circumstances of the *Western Pacific* case, should go far toward resolving any lingering doubt as to the fairness and equity of the Commission Plan toward the James Interests and RCC.

It affords in a substantial measure an ultimate pragmatic test of the soundness of the Commission's determina-

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[1] R. 350-52.

[2] *Supra*, pp. 14-15.

tion as to the value of the Debtor's properties for reorganization purposes. It also furnishes a practical test as to the sincerity of the James Interests and RCC in their constant assertions that the Debtor's properties are worth more than the amount of the senior secured claims—indeed, worth more than the full amount of all the secured claims. If the James Interests honestly believe the Debtor's properties to be worth more than the approximately $88,000,000 of secured claims,[1] the provision of the Commission Plan for an offer of the properties at an upset price will give the James Interests, as well as RCC, opportunity to render the Commission Plan nugatory by buying in the properties at such sale and capitalizing them in whatever manner they may determine, with the approval of the Commission.

In the literature dealing with reorganization problems, judicial sales of railroad properties have sometimes been characterized as meaningless fictions on the ground that junior creditors and stockholders are usually large numbers of small investors with small resources, wholly unorganized.

In the *Western Pacific* case the tenacity of the James Interests, and the battery of eminent counsel appearing for the several corporate entities included in the James Interests, evidence both the capacity for organization and the presence of adequate resources among the junior interests. This, therefore, is not the ordinary situation, but is one in which all of the dissenters are large corporations and, except for RCC, under common control. A judicial sale will be no meaningless gesture but, on the contrary, as above pointed out, will afford a practical test of the dissenters' contentions not only as to the value of the Debtor's properties

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[1] As of January 1, 1943, the amount, including accumulated unpaid interest, will exceed $100,000,000.

as an aggregate but as to the value of the properties upon which the Refunding Mortgage is a first lien.

From the legal standpoint such a sale will also clearly constitute "due process" in the elimination of the interests of WP Corp., should it fail to purchase the properties at such sale. As to the ACJ and RCC Notes, the Commission Plan preserves to them, notwithstanding any failure on their part to bid in the Debtor's properties at such a sale, an option to take the new securities allotted to them in the Plan in lieu of their aliquot portion of the proceeds of the sale.

Respectfully submitted,

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Dated October 12, 1942.

APPENDIX A

Reconstruction Finance Corporation Act, Section 5 (15 U. S. C. § 605), as amended September 18, 1940[1]

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Each such loan may be made for a period not exceeding three years, and the corporation may from time to time extend the time of payment of any such loan, through renewal, substitution of new obligations, or otherwise, but the time for such payment shall not be extended beyond five years from the date upon which such loan was made originally. The corporation may make loans under this section at any time prior to the expiration of one year from January 22, 1932; and the President may from time to time postpone such date of expiration for such additional period or periods as he may deem necessary, not to exceed two years from January 22, 1932. Within the foregoing limitations of this section, the Corporation, notwithstanding any limitation of law as to maturity, *with the approval of the Interstate Commerce Commission, including approval of the price to be paid, may, to aid in* the financing, *reorganization,* consolidation, maintenance, or construction thereof, *purchase* for itself, or for account of a railroad obligated thereon, the *obligations* of railroads engaged in interstate commerce, or of receivers or trustees thereof, including equipment trust certificates, or guarantee the payment of the principal of, and/or interest on, such obligations, including equipment trust certificates, or, *when, in the opinion of the Corporation, funds are not available on reasonable terms through private channels, make loans,* upon full and adequate security, to such railroads or to receivers or trustees thereof for the purposes aforesaid: Provided, That in the case of loans to or the purchase or guarantee of obligations, including equipment trust certificates, of railroads not in receivership or trusteeship, the

[1]Italics in the text of the statute are supplied.

Interstate Commerce Commission shall, in connection with its approval thereof, also certify that such railroad, on the basis of present and prospective earnings, may reasonably be expected to meet its fixed charges, without a reduction thereof through judicial reorganization, except that such certificate shall not be required in case of such loans, purchases, or guaranties made for the maintenance of, or purchase of equipment for, such railroads: Provided further, That for the purpose of determining the general funds of the Corporation available for further loans or commitments, such guaranties shall, to the extent of the principal amount of the obligations guaranteed, be interpreted as loans or commitments for loans: And provided further, That the total amount of loans and commitments to railroads, receivers, and trustees, and purchases and guaranties of obligations of railroads, under this paragraph, as amended, shall not exceed at any one time $500,000,000, in addition to loans and commitments made prior to January 31, 1935, and renewals of loans and commitments so made: *Provided, That no fee or commission shall be paid by any applicant for a loan under the provisions hereof in connection with any such application or any loan made or to be made hereunder, and the agreement to pay or payment of any such fee or commission shall be unlawful.* Any such railroad may obligate itself in such form as shall be prescribed and otherwise comply with the requirements of the Interstate Commerce Commission and the corporation with respect to the deposit or assignment of security hereunder; without the authorization or approval of any authority, State or Federal, and without compliance with any requirement, State or Federal, as to notification, other than such as may be imposed by the Interstate Commerce Commission and the corporation under the provisions of this section. The title of any owner, whether as trustee or otherwise, to any property leased or conditionally sold to a railroad, or a receiver or trustee thereof, which the Corporation has financed, or in the financing of which the Corporation has aided, any right of such owner to take possession of such property in

compliance with the provisions of any such lease or conditional sales contract, and the title of any owner of a collateral note evidencing a loan from the Corporation to a railroad not now in receivership or involved in proceedings under section 205 of Title 11, or a receiver or trustee thereof, and the right of any such owner to acquire title to the collateral securing such note, free and clear of any equity of redemption, in compliance with the contract of pledge, and thereafter to deal with the same as the absolute owner thereof, shall not be affected, restricted, or restrained by or pursuant to the provisions of Title 11, as amended, or by or pursuant to any other provision of law applicable to any proceedings thereunder.